

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 91-095-W - ORDER NO. 92-350
MAY 13, 1992

IN RE: Application of Upstate Heater Utilities,) ORDER
Inc. for Approval of Adjustments in its) APPROVING
Rates and Charges for Water Service.) RATES AND ✓
) CHARGES

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of an application of Upstate Heater Utilities, Inc. (the Company or UHU) for approval of a new schedule of rates and charges for its customers in South Carolina. The Company's November 14, 1991, application was filed pursuant to S.C. Code Ann. §58-5-240 (1976), as amended, and R.103-821 of the Commission's Rules of Practice and Procedure.

By letter dated November 25, 1991, the Commission's Executive Director instructed the Company to publish a prepared Notice of Filing and Hearing, one time, in a newspaper of general circulation in the area affected by the Company's application. The Notice indicated the nature of the Company's application and advised all interested parties desiring participation in the scheduled proceeding of the manner and time in which to file the appropriate pleadings. The Company was likewise required to notify directly all customers affected by the proposed rates and charges.

Petitions to Intervene were filed on behalf of Steven W. Hamm, the Consumer Advocate for the State of South Carolina (the Consumer Advocate), Chester G. Kapp, Thomas J. Studebaker, Rudolph Cole, and The Town Creek Community Association. The Commission Staff made on-site investigations of the Company's facilities, audited the Company's books and records, and gathered other detailed information concerning the Company's operations. The other parties likewise conducted their discovery in the rate filing of UHU.

A public hearing relative to the matters asserted in the Company's application was held on March 12, 1992, in the Hearing Room of the Commission at 111 Doctor's Circle, Columbia, South Carolina. Pursuant to S.C. Code Ann. §58-3-95 (Cum. Supp. 1991), a panel of three Commissioners composed of Commissioners Frazier, Butler, and Mitchell was designated to hear and rule on this matter. Darra W. Cothran, Esquire, represented the Company; Carl F. McIntosh, Esquire, represented the Consumer Advocate; and Marsha A. Ward, General Counsel, represented the Commission Staff. Intervenors Kapp and Studebaker appeared on their own behalf. James Bredenkamp made a statement as a Protestant.

The Company presented the direct testimony of William E. Grantmyre, President of the Company and Freda Hilburn, Director of Regulatory Accounting to explain the services being provided by the Company, the financial statements, the accounting adjustments submitted, and the reasons for the requested rates. The Company submitted rebuttal testimony from these same witnesses, as well as

Jerry H. Tweed, Director of Regulatory Relations and Environmental Affairs. The Consumer Advocate presented the testimony of Philip E. Miller, Riverbend Consulting, who analyzed the Company's application and revenue requirements. The Commission Staff presented the testimony of Charles A. Creech, Chief, Water and Wastewater Department, and Bruce Hulion, Public Utilities Accountant. Intervenors Kapp and Studebaker presented their opposition to the proposed increase.

FINDINGS OF FACT

1. The Company is a wholly-owned subsidiary of Heater Utilities, Inc. The Company is a water utility operating in the State of South Carolina and is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §58-5-10 (1976) et seq. Application of Company; Grantmyre testimony.

2. The Company provides water service to approximately 1,160 customers in Anderson and Abbeville Counties, South Carolina. Application of Company, Hearing Exhibit No. 8, Water and Wastewater Department, Part E.

3. The Company's present rates and charges were approved by Order No. 83-412, dated July 19, 1983, in Docket No. 83-160-W.¹ Hearing Exhibit No. 8; files of the Commission.

4. At present, the Company has a minimum charge of \$8.75 for the first 2,000 gallons and a commodity charge of \$1.90 per

1. UHU bought the Hughes Water System, Inc. and operated the system under the approved rates for Hughes. The transfer was approved by Order No. 90-573, dated June 5, 1990 in Docket No. 90-330-W.

1,000 gallons used over 2,000. The Company also charges a set meter tap fee to be paid by the developer of \$120.00 for Purdy Shores and \$150.00 for Purdy Plantation. The Company proposes to change its tap fee to \$500.00. The Company proposes to change its water reconnection fee of \$15.00 to \$30.00 and proposes a new customer account charge of \$22.00. The Company proposes to increase its basic facility charge to \$9.00 per month, plus a commodity charge of \$2.90 per 1,000 gallons. Based on the average test year consumption of 5,625 gallons/per residential customer, the water increase amounts to an additional \$9.67/month or an increase of 61.83%. Application of Company; Hearing Exhibit No. 8, Water and Wastewater Department, Parts A, and C.

5. The Company asserts this requested rate increase is required because the Company has experienced substantial increases in operating expenses such as purchased water, property tax expense, testing fees including the VOC monitoring required by the Safe Drinking Water Act, postage, DHEC annual operating permit fees, materials and supplies, increased field service operations due to the requirements of the Safe Drinking Water Act. The Company has experienced for the test year ending July 31, 1991, after accounting and pro forma adjustments, a loss of \$79,200, after interest expense. The operating margin after interest expense under current rates after accounting and pro forma adjustments was (35.88%).

The total coliform rule effective January 1, 1991 has increased the monitoring and water treatment costs. The Company

asserts it needs the rate increase in order to continue to improve the quality of service rendered to its customers. Further, the Company needs the rate increase to earn a profit on its operations which is necessary to maintain the financial integrity of the corporation. The earning of a profit is necessary to enable the Company to attract the needed capital for plant additions and modifications to meet water quality requirements and more stringent public health and environmental regulations and standards required in 1992 and future years. Grantmyre testimony; Application of Company, Exhibits E and J.

6. The Company proposes that the appropriate test period to consider its requested increase is the twelve-month period ending July 31, 1991. Hilburn testimony; Application of Company. The Staff concurred in using the same test year for its accounting and pro forma adjustments. Hulton testimony, Hearing Exhibit No. 8.

7. Under its presently approved rates, the Company states its operating margin after interest and after accounting and pro forma adjustments is (35.88%). Application of Company, Exhibit J. The Company seeks an increase in its rates and charges for water service which would result in an operating margin of 9.45%. Application of Company, Exhibit J.

8. Under the Company's presently approved rates, the Company states that its operating revenues for the test year, after accounting and pro forma adjustments, are \$220,752. The Company seeks an increase in its rates and charges for water

service in a manner which would increase its operating revenues by \$134,457. Application of Company, Exhibit C.

9. Under the Company's presently approved rates, the Staff found that the Company's per book operating revenues for the test year were \$222,067, after accounting and pro forma adjustments. The Staff calculated the proposed increase to be in the amount of \$134,711. Hearing Exhibit No. 8, Accounting Exhibit A.

10. The Company asserts that under its presently approved rates, its total operating expenses for the test year, after accounting and pro forma adjustments are \$258,858. Application of Company, Exhibit C. Staff concluded that the Company's operating expenses for the test year, after accounting and pro forma adjustments, are \$259,505. Hearing Exhibit No. 8. Staff arrived at this proposal after making its adjustments to the Company's expenses. The Commission need only address those adjustments where the Company, the Staff, the Consumer Advocate, or the other intervenors disagree:

A. DEPRECIATION EXPENSE

The Commission Staff and the Company proposed different adjustments to annualize depreciation expense. The Commission Staff recommended that an adjustment of \$7,290 be made to annualize depreciation expense, while the Company proposed an adjustment of \$7,541. The Consumer Advocate did not propose a specific adjustment to annualize depreciation expense. The Staff's review and the Company's responses to several interrogatories revealed that some contributions had been

erroneously included by the Company in plant. Staff increased contributions in aid of construction and decreased depreciation expense for depreciation related to these contributions in aid of construction. Testimony of Hulion, Hearing Exhibit No. 8.

B. GROSS RECEIPTS TAX

The Commission Staff and the Company proposed to adjust gross receipts tax to the proper level for the present Company revenues. The Commission Staff's gross receipts tax adjustment is based on the annualized revenues supplied by the Water and Wastewater Department pursuant to its billing analysis. Staff's adjustment amounts to \$1,182. Testimony of Hulion, Hearing Exhibit No. 8.

C. TRANSPORTATION EXPENSE

The Staff and Company proposed to adjust transportation expense to reflect the current level. Staff used the latest available actual information and annualized this amount. The Staff's adjustment amounted to \$1,146. The Company proposed to adjust the expense based on estimated amounts. The Company's adjustment amounts to \$1,403. Testimony of Hulion, Hearing Exhibit No. 8.

D. RATE CASE EXPENSES

The Staff and the Company proposed to amortize rate case expenses over three years. The Company, however, used estimated expenses in its proposal, while the Staff used actual expenses incurred at the time of the Commission Staff audit. During the hearing, the Company presented additional documentation which supported additional rate case expenses of \$13,511.65. That

amount, plus \$486 of rate case expenses identified by Staff, amortized over three years amounts to \$4,665.00. Testimony of Hulton, Hearing Exhibit No. 8, Rebuttal Testimony of Hilburn.

E. BANKING EXPENSES

During Staff's review of the Company's banking costs, the Commission Staff found an item included in the Company's calculation that is not allowed for ratemaking purposes. This amount was a NSF charge by the bank. Therefore, Staff's adjustment to general expenses amounted to a negative \$64, while the Company's adjustment to general expenses amounted to a negative \$7.00.

F. CHEMICAL EXPENSE

Staff proposed to adjust chemical expense for the cost of treating the wells. During Staff's audit, the Company furnished information demonstrating the cost increase for chemicals used in treating its wells that it had failed to include in the original application. This adjustment amounts to an increase in operating and maintenance expenses of \$246.

G. MISCELLANEOUS EXPENSE

Both the Staff and the Company proposed to adjust miscellaneous expense to reflect amounts properly assigned to the Company. The Commission Staff discovered a math error in the calculation of this adjustment resulting in lower charges for the "as adjusted" amount resulting in a larger decrease from the per books charges. Staff's adjust amounts to a negative \$696.

H. MISCELLANEOUS EXPENSE-TELEPHONE

Staff and the Company proposed to annualize miscellaneous expense-telephone to properly reflect that annual expense. Staff's adjustment updated the Company's cellular telephone bills and annualized the result. Staff's adjustment amounts to an increase in general expenses of \$2,026.

I. POSTAGE EXPENSE

Both the Staff and the Company proposed to reflect the annual postage expense. A component of this adjustment, monthly billings was reviewed and increased by the Commission Staff, which resulted in a higher annualized postage expense. Staff's adjustment amounts to an increase in general expenses of \$802.

J. INTEREST SYNCHRONIZATION

Both the Staff and the Company proposed to record the effects of interest synchronization on income taxes. The Company's adjustment differs from the Commission Staff's because of its proposed adjustment to interest expense. The interest synchronization adjustment computes the income tax effect of annualizing interest expense for ratemaking purposes. Staff's annualized interest is computed on Exhibit A-4 of Hearing Exhibit No. 8, which computes the amount of income needed to cover embedded cost rates on long-term debt. Such interest on long-term debt was substituted by Staff for per book interest in computing income taxes. Staff's adjustment amounts to an increase in income taxes of \$10,134.

K. CUSTOMER GROWTH

The Staff proposes to compute the effects of customer growth based on as adjustment net operating income. The Staff does not recognize negative growth, and therefore proposed to delete growth on an as adjusted basis. Staff's adjustment of a negative \$101 was made to eliminate customer growth on an as adjusted basis.

L. INCOME TAXES

The Staff and the Company proposed to true-up income taxes based on "as adjusted" taxable income. The difference between the Commission Staff's adjustment and the Company's is based on differences in other adjustments which would affect the Company's income. Staff's adjustment amounts to an additional \$24,304. This adjustment is made to lower per book income taxes to zero because on an as adjusted basis, the Company does not have any taxable income. Testimony of Hulton, Hearing Exhibit No. 8. In its brief, the Consumer Advocate challenged the Staff and Company's treatment of Upstate Heater on a consolidated basis for income tax purposes. The Consumer Advocate is of the opinion that the Company should be treated on a stand-alone basis for such purposes.

M. OPERATING EXPENSES

The Consumer Advocate, as well as Intervenor Kapp and Studebaker opposed the Company's operating expenses on a total basis. Witness Miller, and witnesses Kapp and Studebaker testified that the Company's operating expenses are "exorbitant." Mr. Miller testified that the operating expenses of the system

when the former owner operated the system compared to the operating expenses of UHU do not compare favorably. Mr. Miller stated that in 1989 under the former owners, there was a net profit of \$75,098 before interest and income taxes. However, the same numbers for the test year, which reflect the first full year the Company operated the system show the operating expenses increasing to \$212,963 and the income before interest and taxes dropping to \$7,205. Moreover, Mr. Miller was of the opinion, that a large portion of the 37% increase in operating expenses is in the general expense category where the majority of the allocated costs from Heater Utilities Operations Center are charged. Mr. Kapp was of the opinion that the Company's reasons for increases of its operating costs have not been shown to justify the requested rate increase.

Company witness Grantmyre testified that the assumptions regarding the increased operating expenses pointed out by the Consumer Advocate as based upon unaudited financial data included in the 1989 Annual Report of the previous owner. Mr. Grantmyre further testified that water utilities owned by well drilling companies normally do not properly segregate the inter-related operating expenses, which result in the water company being subsidized by its owner, the well drilling company. Mr. Grantmyre introduced the Annual Reports of Hughes Water System, Inc. (the former owner) for the years 1986, 1987, and 1988 which show significantly higher levels of operating expense than the unaudited 1989 Report used by the Intervenor for comparison. The

average operating expenses for the three years presented by Mr. Grantmyre in the Hughes annual reports were \$192,265.

The Consumer Advocate challenged the allocations of the salaries of other persons in the parent Company, Heater Utilities, to the Upstate Heater operations. Mr. Grantmyre stated that the salaries are allocated based upon the actual daily time sheets kept by every employee. The total time allocations of the five Heater employees listed by witness Miller as being examples of unnecessary employees charged to Upstate Heater Utilities amounts to a combined total of 9.18% of the employees total time.

Witness Hilburn testified on rebuttal that Heater Utilities provides centralized corporate services from its operations center including, but not limited to accounting, accounts payable, billing, customer service, payroll, purchasing, and human resources for the entire consolidated Company. Upstate's accounting records and data are maintained and stored at the operations center. Accountants working at the operations center ensure that Upstate's accounting records are maintained in compliance with standards required by the Commission. The Accounts Payable Department issues checks to Upstate's creditors. The Customer Service Department processes Upstate's customer payments mailed to the operations center, and notifies the Upstate customer regarding late payments and shutoff for non-payment. Upstate's monthly bills are mailed from the operations center. Payroll functions such as employees' paychecks, payment of state and federal unemployment taxes, as well as social security taxes

are processed for Upstate employees at the operations center. In addition, human resources functions as the maintenance of group medical insurance, long-term disability insurance, dental insurance, and pension plan are processed at the operations center for Upstate employees. According to Ms. Hilburn, Upstate customers directly benefit from the services that employees located at the operations center provide.

N. SALARIES AND WAGES

The Consumer Advocate contends that after a review of the responsibility for all the employees, as well as those of Hughes Well Drilling, that many of the job functions overlap. As a result, according to the Consumer Advocate, there is a question as to whether or not the Company's salaries and wages are reasonable for a Company of its size. Witness Grantmyre, on rebuttal, testified, as mentioned previously, to the allocations and method of allocation of Heater Utilities' Operations Center employees to Upstate Heater. Witness Hilburn also provided testimony in rebuttal to this position. The time sheets and allocations presented by the Company resulted in less than one-tenth of one employee being allocated to Upstate from the Operations Center for the five questioned positions. Witness Grantmyre also testified regarding the reasonableness of the overall level of salaries and wages and stated that virtually all of the professional services are provided in-house, including accounting and bookkeeping, much of the legal work, repairs and maintenance, and pump installations and replacements.

O. TEST YEAR SALES

Consumer Advocate witness Miller testified that the test year sales level was abnormally low in comparison to the sales levels experienced in recent years. In addition, Mr. Miller testified that the average sales per customer associated with the test year sales levels were lower than the national average, but that the same average sales per customer for the levels experienced during the periods previous to the test year were consistent with the national average. The Consumer Advocate contends that this demonstrates that the test year sales levels are abnormally low. As a result, Mr. Miller recommended that the test year sales levels be adjusted to reflect the average sales levels for the previous four year period. The Consumer Advocate contends that if an adjustment is not made, the Company will be in a position to experience a windfall profit if the sales levels realized during the time the rates approved in this case are in effect because those rates will have been determined on a lower sales level.

The Company responded to the Consumer Advocate's position through the rebuttal testimony of Jerry Tweed. Mr. Tweed noted that witness Miller presented information which demonstrated an approximate 1.1% increase in sales in 1989, a 6.6% decrease in 1990, and a 2.6% decrease in 1991. Mr. Miller took the average of the four years and subtracted the test year usage to quantify his "excess" gallonage to be sold in future years. According to Mr. Tweed, Upstate filed its rate case based on the most recent twelve-month historical period for which it had records. An

historic test year filing is required in South Carolina, according to Mr. Tweed, although the test year data may be adjusted for known and measurable changes. Mr. Tweed points out that the Consumer Advocate's proposal assumes that the customers of Upstate will use 4,280,000 more gallons during future years than they did during the test year. According to Mr. Tweed, this is not a known and measurable change. Mr. Tweed points out that the test year could have been normal and that the other years in question by the Consumer Advocate could have had a higher consumption than normal due to factors such as lawn irrigation or drought conditions. Mr. Tweed prepared a chart which depicted the annual usage for several test periods which Heater could have used. The information provided by Mr. Tweed demonstrated that the test years vary from 500,000 gallons below to 400,000 above the test year usage. Mr. Tweed also pointed out that corresponding upward adjustments to several expense accounts would need to be made to assure that revenues are matched with expenses. These adjustments would be difficult to quantify, according to Mr. Tweed.

P. UNACCOUNTED FOR WATER

The Company presented an unaccounted for water analysis on four systems in which Upstate Heater purchases bulk water from an outside supplier through a master meter. The analysis shows a 6.18% unaccounted for water on these four systems. Consumer Advocate witness Miller recommended that no increase be allowed until data is available on all systems. The Company testified that it does not have master meters on its well systems, and,

therefore, could not provide an unaccounted for water analysis for all of its systems. While witness Tweed testified that it is in the process of installing master meters on the wells, he added that the meters will not have the degree of accuracy required for unaccounted for water analysis due to the pressure surge when the well comes on line. Rebuttal testimony of Tweed; Testimony of Miller.

Q. MOTION FOR APPROVAL OF REFUNDS

As part of this proceeding, the Company filed a Motion for Refund of previous customer contributions in aid of construction made on behalf of the customers in the Hill and Dale water system to the Hammond Water Company system for the purchase of bulk water. These payments were made to Hughes Water Systems, Inc., the previous owner, and the agreement provided that the customers would pay \$5,250.18 of the projected capital cost for the purchase of this bulk water. The 39 homeowners of Hill and Dale did, in fact, pay the amount. Additionally, in 1986 the customers in Oakwood Estates and Hughes Water Systems, Inc. entered into a contract whereby the lot owners agreed to pay \$150 each for a portion of the cost of the connection of Oakwood Estates to the Hammond Water Company system. The customers of Oakwood Estates paid a total of \$7,350. The Motion further alleges that Hill and Dale and Oakwood Estates are the only two water systems which paid assessments for the connection for the purchase of bulk water from Hammond Water Company or from any other bulk water supplier. In 1986, Hughes Water System, Inc. made a bulk water connection to

Duke Power Company and purchased bulk water for Bellmede water system whereby those customers were not assessed. Additionally, Dobbins Estates' customers were not assessed for bulk water.

According to the Motion, it is not the current or past policy of Upstate or its parent company, Heater Utilities, to obtain the voluntary assessments from customers for capital improvements. Upstate is of the opinion that the assessments were not justified based on the current and future requirements of the Safe Drinking Water Act where more future connections will be needed by Upstate for bulk water purchases. Upstate's Motion states that the most equitable solution is to refund to the customers of Hill and Dale and Oakwood Estates water systems the principal amounts paid to Hughes Water Systems, Inc. for these two connections. The amount of the refund made by Upstate would be treated on Upstate's books as a reduction in contributions in aid of construction.

Mr. Kapp opposed Upstate's proposal to refund past assessments and stated that Upstate's policy not to assess the individual subdivisions for capital improvements is unfair to those customers that the improvements do not affect. Mr. Kapp urged the Commission to adopt a rule which would require the Company to follow a policy of customer and developer assessment to pay for cost of water treatment, capital improvements, and cost of system development. Mr. Kapp was of the opinion that a customer assessment policy, in effect, establishes a two-tiered surcharge rate schedule which would be fair to all concerned. The customers of well water systems and purchased water systems would only pay

the costs applicable to their systems; Upstate would be allowed to apply an appropriate surcharge early after making an expenditure without the "hassle" of a rate increase hearing. Testimony of Kapp; Brief of Kapp.

R. VIOLATION OF CONTRACT

Mr. Studebaker testified that in his opinion, the proposed increase of Upstate Heater violates the terms of a contract entered into in November of 1977 involving Hughes Water Systems, Inc., the predecessor company. The Commission makes no finding as to the legality of the terms of the contract, but finds that the Commission has jurisdiction over public utilities in this State and it is the Commission who has the right to allow for just and reasonable rates for utilities under its jurisdiction.

11. The Company's records, after accounting and pro forma adjustments to its operating revenues and expenses, reflect a net income for return of (\$38,106). Application of Company, Exhibit C. The Staff calculated the Company's net income for return, after accounting and pro forma adjustments to be (\$37,438). Hearing Exhibit No. 8, Accounting Exhibit A.

12. The Company has applied for rates which will result in a operating margin of 9.45%, Application of Company, Exhibit J.

13. The Commission Staff calculated the operating margin, after interest, to be 11.59% under the proposed rates and assuming Staff's adjustments. Hearing Exhibit No. 8.

CONCLUSIONS OF LAW

1. The Company is a water utility providing water service in its service area in South Carolina. The Company's operations in South Carolina are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann., §58-5-10 et seq. (1976), as amended.

2. A fundamental principle of the ratemaking process is the establishment of an historical test year with the basis for calculating a utility's rate base and, consequently, the validity of the utility's requested rate increase. While the Commission considers a utility's proposed rate increase based upon occurrences within the test year, the Commission will also consider adjustments for any known and measurable out-of-test year changes in expense, revenues, and investments, and will also consider adjustments for any unusual situations which occurred in the test year. See, Parker v. South Carolina Public Service Commission, 280 S.C. 310, 313 S.E.2d 290 (1984), citing City of Pittsburgh v. Pennsylvania Public Utility Commission, 187 P.A. Super. 341, 144 A.2d 648 (1958); Southern Bell v. The Public Service Commission, 270 S.C. 590, 244 S.E.2d 278 (1978).

3. The Company chose the test year ending July 31, 1991. The Commission Staff used the same test year in calculating its adjustments. The Commission is of the opinion that the test year ending July 31, 1991, is appropriate based on the information available to the Commission. The test year ending July 31, 1991, is the appropriate test year for the purpose of this rate request.

4. The Commission concludes that the Staff's adjustments to the Company's operating revenues are appropriate. The Staff's adjustments recognize the annual level of revenues based on a billing analysis performed by the Company and audited by the Staff, the adjustment to annualize uncollectables and corresponding income tax effect. Accordingly, the Commission finds that the appropriate level of revenues for the Company for the test year under the present rates and after accounting and pro forma adjustments is \$222,067.

5. The Commission also concludes that the Staff's adjustments to the Company's operating expenses are appropriate with the following exception. The Commission makes this conclusion based the following legal principles and reasoning:

A. DEPRECIATION EXPENSE

Based upon the Staff's access to the Company's information relating to the accrual rates used by the Company in the depreciable plant amounts at the end of the test year, the Commission finds that sufficient information exists to adopt Staff's adjustments to depreciation expense which are based upon appropriate regulatory and accounting treatments.

B. GROSS RECEIPTS TAX

The Commission concludes that the Commission Staff appropriately based its adjustment on the appropriate amount of annualized revenues pursuant to the Water and Wastewater Department's billing analysis. Therefore, Staff's adjustment of \$1,182 is adopted for ratemaking purposes.

C. TRANSPORTATION EXPENSE

The Commission concludes that it is more appropriate to use actual information when such is available. The Commission Staff used actual information to reflect the current level of travel expense experienced by the Company. Therefore, Staff's adjustment of \$1,146 is adopted for ratemaking purposes.

D. RATE CASE EXPENSES

The Commission concludes that it is not appropriate to include estimated rate case expenses for ratemaking purposes. The Company provided an exhibit through Hilburn's rebuttal testimony which included supporting vouchers and bills submitted by counsel and the Company's employees time for the rate case expenses. The Commission concludes that this type of submittal is appropriate and is properly included for ratemaking purposes. The Commission accepts these actual rate case expenses and will amortize them over three years. The total annual amortization for rate case expenses is \$4666.00.

E. BANKING EXPENSES

The Commission concludes that the Staff's elimination of the NSF charge should be allowed for ratemaking purposes, therefore, the Commission adopts Staff's adjustment to general expenses in the amount of (\$64.00).

F. CHEMICAL EXPENSE

The Commission concludes that it is appropriate to use the information obtained during Staff's audit that an increase in the cost for chemicals used in treating the Company's wells will be an

ongoing expense. Therefore, Staff's adjustment to increase O&M expenses to \$246 is appropriate.

G. MISCELLANEOUS EXPENSE

The Commission concludes that Staff's adjustment to miscellaneous expenses more accurately reflects the appropriate level in that account. The Commission adopts Staff's adjustment of (\$696) for ratemaking purposes.

H. MISCELLANEOUS EXPENSE-TELEPHONE

The Commission concludes that Staff's proposed adjustment accurately reflects the updated expenses of the Company as to its cellular bills. The Commission adopts Staff's adjustment for ratemaking purposes in the amount of \$2,026.

I. POSTAGE EXPENSE

The Commission concludes that the Commission Staff's adjustment to postage expense which reflected the monthly billings of the Company is appropriate for ratemaking purposes, and is hereby adopted in the amount of \$802.

J. INTEREST SYNCHRONIZATION

The Commission concludes that Staff's adjustment to record the effects of interest synchronization on income taxes is appropriate. Staff's annualization of the Company's interest is appropriate for ratemaking purposes. Therefore, the Commission will increase income taxes by \$10,134.

K. CUSTOMER GROWTH

The Commission concurs that the Staff's proposal not to recognize negative growth and this has been a long standing policy

of the Commission. Therefore, it is appropriate to eliminate customer growth on a as adjusted basis by the Commission Staff's adjustment of (\$101).

L. INCOME TAXES

The Consumer Advocate's statement in his Brief that "the Commission has determined in past cases that utilities should be treated on a stand alone basis for income tax purposes..." is inconsistent with the Commission's present policy. See, Docket No. 91-096-W, Application of Heater Utilities; Docket No. 89-610-W/S, Application of Carolina Water Service, Inc., among others. In deed, the Commission's policy is to use a consolidated basis for income tax purposes. Further, there is nothing in the record to demonstrate the treatment put forth by the Company and the Staff is inappropriate. The Commission concludes that a consolidated basis is appropriate to calculate income taxes for ratemaking purposes.

M. OPERATING EXPENSES

The Commission finds that the Consumer Advocate's proposal disallow any increase in rates until the Company justifies the level of operating expenses should be denied. The Company has adequately supported its operating expenses through the direct and rebuttal testimony of its witnesses. Upstate additionally demonstrated that its customers benefit from the service that derived from the operations center.

N. SALARIES AND WAGES

The Consumer Advocate questioned the reasonableness of the Company's salaries and wages for a company of its size. The Commission concludes that the Company, through the rebuttal testimony of witness Grantmyre and Hilburn that the allocations and method of allocation of Heater Utilities operations center employees to Upstate are appropriate. Additionally, the allocation resulted in less than one-tenth of one employee being allocated to Upstate from the operations center for the positions questioned by the Consumer Advocate. The Commission concludes that the salaries and wages experienced by the Company are allowable for ratemaking purposes.

O. TEST YEAR SALES

The Commission concludes that the test year sales levels were not "abnormally low" for the test year. Although the Consumer Advocate attempted to demonstrate that the average sales per customer associated with the test year sales were lower than the national average, and that during other periods the average test year sales per customer were consistent with the national average, the Commission finds that this does not demonstrate that the test year sales were abnormally low. The Commission was convinced by the testimony of witness Tweed which indicated that the historic test year provides known and measurable data for the test year sales. The Consumer Advocate's proposal makes an assumption that the customers of the Company will use 4 million more gallons during future years than they did during the test year. This is

not a known and measurable change. Additionally, under the Consumer Advocate's position, test year expenses would have to be increased on a similar basis, which would not be a known and measurable or quantifiable adjustment. Therefore, the Commission accepts the test year sales as filed by the Company.

P. UNACCOUNTED FOR WATER

The Commission concludes that the Consumer Advocate's recommendation that no increase be granted until data on all unaccounted for water is available should be denied. The Commission is convinced by the testimony of witness Tweed that unaccounted for water may not be available for all of the Company systems, nor would such be practicable. The Commission Staff additionally reviewed the unaccounted water and found that the 6.18% unaccounted for water on the four systems was reasonable based on prior Commission decisions.

Q. MOTION FOR APPROVAL OF REFUNDS

The Commission concludes that the Company's Motion for Refund of previous customer contributions in aid of construction should be denied. The Company is under no obligation to provide a refund of dollars collected by the previous owner of the system. Moreover, the Company proposed that the refunds be made with ratepayer dollars. While Mr. Kapp opposed the Company's policy of not assessing individual system customers for plant improvements necessary for a particular system, the Commission is of the opinion that it has been this Commission's policy to encourage policies such as that of Upstate Heater's. This policy of

non-assessment goes hand-in-hand with the Commission's policy of uniform rates in which the total utility costs are spread over the total utility customer base. Therefore, all customers receiving service from a utility would pay the same price for the service received on a total system basis. The Commission is of the opinion that it is more appropriate for all ratepayers to share the cost of providing service on a total system basis rather than to unfairly burden the customers of a particular system that may need a large capital improvement.

R. VIOLATION OF CONTRACT

The Commission concludes that it has the sole jurisdiction to determine the just and reasonable rates for water service provided by Upstate Heater Utilities, Inc. The contract in question would not affect the Commission's jurisdiction to make the appropriate rate determinations.

S. OTHER ADJUSTMENTS

The Commission concludes that since there were no objections to the other adjustments proposed by the Commission Staff, that these adjustments, as supported by the record are appropriate for ratemaking purposes. The Commission hereby adjusts general taxes and state and federal income taxes to reflect all other adjustments approved by the Commission.

6. Accordingly, the Commission concludes that the Company's appropriate operating expenses for the test year, after accounting and pro forma adjustments is \$264,009.

7. The Company's appropriate total income for return for

the test year, after accounting and pro forma adjustments is (\$41,942). Based upon the above determinations concerning the accounting and pro forma adjustments to the Company's revenues and expenses, the Commission concludes that the total income for return is as follows:

TABLE A
TOTAL INCOME FOR RETURN

Operating Revenues	\$222,067
Operating Expenses	264,009
Net Operating Income	<u>\$(41,942)</u>
Customer Growth	- 0 -
Total Income for Return	<u>\$(41,942)</u>

8. Under the guidelines established in the decisions of Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in Hope, a utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and...that are adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." Bluefield, supra, at 692-693.

9. There is no statutory authority prescribing the method which this Commission must utilize to determine the lawfulness of the rates of a public utility. For a water utility whose rate base has been substantially reduced by customer donations, tap fees, contributions in aid of construction, and book value in excess of investment, the Commission may decide to use the "operating ratio" and/or "operating margin" method for determining just and reasonable rates. The operating ratio is the percentage obtained by dividing total operating expenses by operating revenues; the operating margin is determined by dividing the net operating income for return by the total operating revenues of the utility. This method was recognized as an acceptable guide for ratemaking purposes in Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

10. Based on the Company's gross revenues for the test year, after accounting and pro forma adjustments under the presently approved schedules, the Company's operating expenses for the test year after accounting and pro forma adjustments, and customer growth, the Company's present operating margin is as follows:

TABLE B
OPERATING MARGIN

BEFORE RATE INCREASE

Operating Revenues	\$222,067
Operating Expenses	264,009
Net Operating Income	<u>\$(41,942)</u>
Customer Growth	- 0 -
Total Income for Return	<u>\$(41,942)</u>
Operating Margin (After Interest)	<u>(30.30%)</u>

11. Based on the Company's proposed increase, after accounting and pro forma adjustments as approved herein, the Company's operating margin would be:

TABLE C
OPERATING MARGIN

AFTER PROPOSED RATE INCREASE

Operating Revenues	\$356,778
Operating Expenses	<u>290,378</u>
Net Operating Income	\$ 66,400
Customer Growth	288
Total Income for Return	<u>\$ 66,688</u>
Operating Margin (After Interest)	<u>(11.59%)</u>

12. The Commission is mindful of the standards delineated in the Bluefield decision and of the need to balance the respective interests of the Company and of the consumer. It is incumbent upon this Commission to consider not only the revenue requirements of the Company but also the proposed price for the water service, the quality of the water service, and the effect of the proposed rates upon the consumer. See, Seabrook Island Property Owners Ass. v. S.C. Public Service Commission, Op. No. 23351 (Filed Feb. 25, 1991); S.C. Code Ann. §58-5-290 (1976).

13. The three fundamental criteria of a sound rate structure have been characterized as follows:

... (a) the revenue-requirement or financial-need objective, which takes the form of a fair-return standard with respect to private utility companies; (b) the fair-cost apportionment objective which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or consumer rationing under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is

economically justified in view of the relationships between costs incurred and benefits received.

Bonbright, Principles of Public Utility Rates (1961), p. 292.

14. Based on the considerations enunciated in Bluefield and Seabrook Island and on the fundamental criteria of a sound rate structure as stated in Principles of Public Utility Rates, the Commission determines that the Company should have the opportunity to earn a 7.41% operating margin. In order to have a reasonable opportunity to earn a 7.41% operating margin, the Company will need to produce \$329,827 in annual operating revenues.

TABLE D
OPERATING MARGIN

AFTER RATE INCREASE

Operating Revenues	\$ 329,827
Operating Expenses	280,241
Net Operating Income	<u>49,586</u>
Customer Growth	215
Total Income for Return	<u>\$ 49,801</u>
Operating Margin (After Interest)	<u>7.41%</u>

15. In fashioning rates to give the Company the required amount of operating revenues so that it will have the opportunity to achieve a 7.41% operating margin, the Commission has carefully considered the concerns of the Company's customers. Several customers testified at the hearing in opposition to the rate increase and, the Commission's files contain many letters of protest. All of the letters protest the amount of the increase. The Commission recognizes that the proposed increase for water customers amounts to a 49.42% increase in the average customer's

bill. However, the Company has not had a rate increase since 1983. The rates designed herein consider the quality of the service provided by the Company to its customers and the need for the continuance of the provision of adequate service, as well as the impact of the increase on those customers receiving service and the need for conservation of water resources.

16. The Commission recognizes the capital improvements that have been made, the increase in operating expenses and the additional DHEC requirements. Further, the Commission recognizes the other increased expenses experienced by the Company and that under the current rates, the Company is experiencing a negative operating margin.

17. The Commission concludes that while an increase in rates is necessary, the proposed increase is unreasonable and inappropriate. Accordingly, the Commission will design rates which will implement a base facility charge for water service of \$8.75 per month. Also, the Company's requested water commodity charge should be reduced to \$2.60 per 1,000 gallons.

18. The Company proposed reconnection and customer account charges of \$30.00 and \$22.00, respectively. The Commission finds that the proposed rates are reasonable and that the proposed increase is granted.

19. The Company proposed a one time tap fee of \$500. The Commission finds that the proposed tap fee of \$500 is appropriate and approves same.

20. Based on the above considerations and reasoning, the


Commission hereby approves the rates and charges as stated in this Order and attached hereto as Appendix A as being just and reasonable. The rates and charges approved are designed in such a manner in which to produce and distribute the necessary revenues to provide the Company the opportunity to earn the approved operating margin.

21. Accordingly, it is ordered that the rates and charges attached on Appendix A are approved for service rendered on or after the date of this Order. The rate schedule is hereby deemed to be filed with the Commission pursuant to S.C. Code Ann. §58-5-240 (1976), as amended.

22. It is ordered that should the approved schedule not be placed into effect before three (3) months after the effective date of this Order, then the approved schedule shall not be charged without written permission of the Commission. It is further ordered that the Company maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A and B water utilities, as adopted by this Commission.

23. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


VICE Chairman

ATTEST:


Executive Director

(SEAL)

APPENDIX A

UPSTATE HEATER UTILITIES INC.
P.O. Drawer 4889
Cary, N.C. 27519
(919) 467-7812

FILED PURSUANT TO DOCKET NO. 91-095-W - ORDER NO. 92-350
EFFECTIVE DATE: MAY 13, 1992

THE SCHEDULE OF WATER RATES AND CHARGES ARE AS FOLLOWS:

METERED RATES (PER SINGLE FAMILY EQUIVALENT):

Basic Facility Charge (monthly)	-	\$ 8.75
Commodity Charge (per 1,000 gal.)	-	\$ 2.60
Water Reconnection Charge	-	\$ 30.00
New Customer Account Charge	-	\$ 22.00

One time fee charged to each account to
defray cost of initiating service.

* Tap fee - \$500.00

* The full gross up will be added to the tap fee.